



ORIGINAL

A subsidiary of Pinnacle West Capital Corporation

Jack Davis  
President and Chief Executive Officer

Tel 602/250-3529  
Fax 602/250-3303



PO Box 53999  
Phoenix, AZ 85072-3999

06

June 2, 2006

Commissioner Kristin K. Mayes  
ARIZONA CORPORATION COMMISSION  
1200 West Washington  
Phoenix, AZ 85007

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**Re: Proposed Devers - Palo Verde No. 2 Power Line  
Docket No. L<sup>00000</sup>A-06-0295-00130**

Dear Commissioner Mayes:

I received your May 11, 2006, letter concerning the proposed Devers-Palo Verde No. 2 (DPV2) Power Line. While Arizona Public Service Company (APS) has not analyzed the application for a Certificate of Environmental Compatibility (CEC), I will attempt to address your questions in a preliminary and somewhat general manner.

As noted in your letter, APS's load is growing at approximately 4%, or almost 300MW, annually. APS is attempting to meet this growth through the competitive market consistent with Decision No. 67744 (April 7, 2005). As the result of a 2005 Request for Proposals (RFP), APS contracted for 1150 MW, with about 40% coming from sources that were identified as being in Arizona. Because APS is using the market to obtain resources, APS cannot say definitively when it would be using the specific assets around Palo Verde. However, if you assume that APS, Salt River Project, and Tucson Electric Power were to acquire all of their additional needs from the assets around the Palo Verde hub, the utilities would grow into the uncommitted capacity in the 2010-2011 timeframe.

You also asked for additional comments on environmental, operational, reliability or economic issues. Let me address each of these issues separately.

#### **ENVIRONMENTAL**

APS has not analyzed the application for a Certificate of Environmental Compatibility ("CEC") for the DPV2 line and therefore is not able to provide comments on the full scope of environmental issues that may be before the Commission and other regulatory agencies involved in approving the line's construction. However, we note that the DPV2 likely will be placed in the same Bureau of Land Management utility corridor with DPV1 for much of its length, which should help mitigate potential environmental impacts.

### **OPERATIONAL**

The addition of DPV2 could provide for more efficient economic dispatch of generation in the southwest region by providing more efficient total loading of new combined-cycle generation, thereby improving overall efficiency of gas use within the region. However, it would not be possible at this point, based on the information available, to determine what, if any, impact such new electric transmission might have on natural gas transportation and supply.

The addition and routing of DPV2 also could open up opportunities to tie in baseload additional resources, including coal, that might be located in western Arizona. Such new resources would benefit both Arizona and the region.

### **RELIABILITY**

APS continues to play an active and leading role in regional transmission planning efforts. APS participates in STEP, SWAT and other regional planning efforts because of APS's view that such planning efforts result in improved overall grid reliability and market enhancement. APS believes that the western states will benefit if all of the states in the region view proposed infrastructure projects (transmission or otherwise) from a regional perspective.

APS generally believes that the Western Electric Coordinating Council (WECC) region will benefit from the addition of interstate transmission such as the DPV2 project. The DPV2 line has been part of the regional planning efforts for many years because of the belief that its addition will increase the grid reliability throughout the region. Studies performed by the STEP sub-regional planning group have shown a reliability benefit for the grid from the addition of DPV2. Another interstate transmission project that could benefit overall grid reliability and is presently under study is the TransWest Express Project (TransWest) that APS has proposed. In addition to improving grid reliability, TransWest would allow APS, SRP and other southwest utilities to access the significant wind and coal resources located in Wyoming. The addition of DPV2 also could facilitate interest in the TransWest project by Southern California utilities, thus increasing the feasibility, and viability, of the project. APS will need to seek siting approval from other states for the TransWest line and hopes that those other states consider the regional value of the project when evaluating APS's request for siting approval.

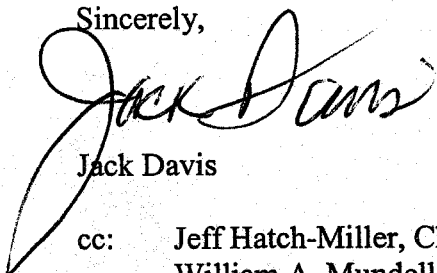
### **ECONOMIC**

The addition of the DPV2 line will allow California utilities to have increased access to generation resources located in Arizona and beyond. While this may impact the prices in Southern California and at the Palo Verde hub, we are not certain exactly

how the market will adjust prices between Southern California and Palo Verde on a seasonal or year to year basis. There are other potential impacts that could offset any increases in Palo Verde prices. For example, besides the positive operational and reliability impacts I just mentioned, the increased access to the California market may provide opportunities to increase off system sales to California, which could then result in higher off-system revenues. In addition, improved transmission infrastructure may lower the cost of entry for additional investment in generation resources and gas delivery facilities.

As a general principle, the Commission has a stated policy of encouraging the development of competition in the energy market. During the last several years, the Commission, APS, and various intervenors, some of which have included out of state merchant generators, have spent considerable time and effort in formulating policies and rules to promote a competitive market for electricity. The efficiency of the Western energy market depends upon the extent and quality of the regional physical infrastructure necessary to produce and transmit energy. The notion that prices may remain lower for Arizona consumers by limiting regional infrastructure is not consistent with a policy of promoting a well-functioning competitive market, which in the long term should reduce pricing. Arizona should be a leader among the Western states in promoting interstate cooperation in the planning and development of new infrastructure. This will encourage new investment and improve the efficient operation of the regional market.

Sincerely,



Jack Davis

cc: Jeff Hatch-Miller, Chairman  
William A. Mundell, Commissioner  
Marc Spitzer, Commissioner  
Mike Gleason, Commissioner  
Brian McNeil  
Ernest Johnson  
Laurie Woodall, Chairman, Arizona Power Plant and Line Siting Committee  
Docket Control